

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

77-6150

To be argued by
ALLAN E. KIRSTEIN

United States Court of Appeals FOR THE SECOND CIRCUIT

Matter of the Accounting of
ABRAHAM D. LEVY,
As Administrator
of

The Estate of CHARLES BROWN a/k/a
CHARLES W. BROWN, Deceased,
STATE OF NEW YORK,

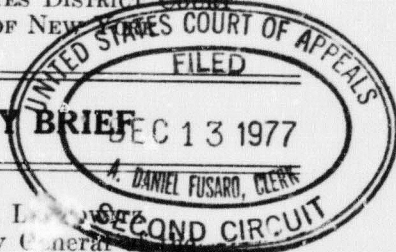
Appellant-Respondent,

UNITED STATES OF AMERICA,

Appellee-Petitioner.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S REPLY BRIEF



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APPELLANT'S REPLY BRIEF

Preliminary Statement

The appellant, the State of New York filed its brief on October 26, 1977 and the appellee, the United States filed its brief on November 28, 1977. The appellant submits this brief in response to the brief of the appellee.

POINT I

Congress was without power to declare an escheat under 38 U.S.C. § 5220 as to property which was not derived from VA benefits.

The United States relies on *United States v. Oregon*, 366 U.S. 643 (1961) which has a similar fact pattern. However, New York State, as appellant herein has cited *National League of Cities v. Usery* to establish a change of position by the United States Supreme Court with regard to its *Oregon* ruling. The United States correctly points out that the facts in *National League* are different from those in the instant case. However, *National League* demonstrates that Congress may not force its will upon the States with respect to the "conduct of integral state functions."

The United States goes on to maintain that "escheat is hardly an integral operation of state government." (Appellee's brief at p. 12). In a most recent (4-26-77) decision involving rights of illegitimate children, the United States Supreme Court addressed itself to that particular point:

The orderly disposition of property at death requires an appropriate legal framework, the structuring of which is a matter particularly within the competence of the individual states. In exercising this responsibility, a *State necessarily must enact laws governing both the procedure and substance of intestate succession*. Absent infringement of a constitutional right, the federal courts have no role here, and even when constitutional violations are alleged, those courts should afford substantial influence to a state's statutory scheme of inheritance. *Trimble v. Gordon*, 45 U.S. Law Week 4395, 4397 (Emphasis added).

Thus, in combination, *National League* preserves essential state rights and *Trimble* defines intestate succession

as a necessary state right. Consequently, New York urges that these two cases together supersede *Oregon* by implication.

POINT II

Property passing to the United States under 38 U.S.C. 5220 is subject to estate tax under Article 26 of the New York Tax Law.

The United States asserts that *United States v. Perkins*, 163 U.S. 625 (1895) is inapplicable since the decision is limited to decedent's power to bequeath. This is not the case, for *Perkins* referred also to a situation where there is no will:

"Thus the tax is not upon the property . . . but upon the right to dispose of it and it is not until it has yielded its contributions to the state that it becomes the property of the legatee. This was the view taken of a similar tax in *State v. Dalrymple*, 70 Md. 294, 299, in which the court observed:

Possessing these, the plenary power indicated it necessarily follows that the state in allowing property * * * to be disposed of by will, and in designating who shall take such property when there is no will may prescribe such conditions, not in conflict with or forbidden by the organic law, as the legislature may deem expedient . . ." *United States v. Perkins*, 163 U.S. 625 (1895)

United States v. Burnison, 1339 U.S. 87 (1950), as also cited in appellee's brief at p. 17 for the same principle, but *Burnison* at p. 95 discusses the possibility of escheat to the United States as well.

The appellee maintains at p. 17 of his brief that *Matter of O'Brine*, 37 N.Y. 2d 81 (1975), cited by New York at p. 11 of appellant's brief applies to a different statute and is not controlling. *O'Brine* involved the same issue,

which is state taxation of property escheating to the United States from the estate of a deceased veteran dying intestate. The only distinction is that in *O'Brine*, the assets in question were properties derived directly from VA benefits. Thus, the United States position in that case was far stronger since the assets originally belonged to the United States. In the case at bar, the property never belonged to the United States.

Even more dispositive of the inclusion of these assets in the gross estate in this case is 38 U.S.C. 5226 pertaining to claims by the rightful claimants for monies held in trust by the V.A. The statute reads in part:

"Upon receipt of due proof that any person was at date of death the veteran entitled to his personal property or a part thereof, under the laws of the State of domicile of the decedent, *the administrator may pay out of the fund, but not to exceed the net amount credited thereto from said decedent's estate less necessary expenses, the amount to which such persons, was or were so entitled . . .*"

The words "net" and "necessary expenses" indicate that the decedent's property is includible in the gross estate and do not immediately pass outside of the decedent's estate directly to the United States.

The appellee states that if the property of the decedent which passes to the United States is subject to New York estate tax, "what would prevent a state from taking 25 or 50 percent of property by way of an estate tax . . ." (appellee's brief, p. 21).

The Supreme Court of the United States answered that very point in *James v. Dravo Contracting Co.*, 302 U.S. 134 (1937):*

"There is the further suggestion that if the present tax of two per cent is upheld, *the State may law a tax*

* See also *Metcalf & Eddy v. Mitchell*, 269 U.S. 519 (1926).

of twenty per cent or fifty per cent or even more, and make it difficult or impossible for the Government to obtain the service it needs. The argument ignores the power of Congress to protect the performance of the functions of the National Government and to prevent interference therewith through any attempted state action. In *Thomson v. Pacific Railroad*, *supra*, the Court pointedly referred to the authority of Congress to prevent such an interference through the use of the taxing power of the State. 'It cannot,' said the Court, 'be so used, indeed, as to defeat or hinder the operations of the National Government; but it will be safe to conclude, in general, in reference to persons and State corporations employed in government service, that *when Congress has not interposed to protect their property from State taxation, such taxation is not obnoxious to that objection.*'" See *Van Allen v. Assessors*, 3 Wall. 573, 585. (302 U.S. at 160, 161) (emphasis added).

Bequests to the United States were considered in *Snyder v. Bettman*, 190 U.S. 249 (1903):

"Having determined, then, that Congress has the power to tax successions; that the States have the same power, and that such power extends to bequests to the United States, it would seem to follow logically that Congress has the same power to tax the transmission of property by legacy to states, or their municipalities, and that the exercise of that power in neither case conflicts with the propositions that neither the federal nor state government can tax the property or agencies of the other, since, as repeatedly held, the taxes imposed are not upon property, but upon the right to succeed to property." (190 U.S. at 250).

The United States repeatedly insists that property passing to the United States is not a transfer and not includible

in the gross estate since it passes by operation of law. However, the government disagrees with itself, since the IRS has issued Treasury Reg. 204-1(b)(2) which conflicts with the view taken by the United States attorney herein:

The power of the owner of a property interest already possessed by him to dispose of his interest, and nothing more, is not a power of appointment, and the interest is includible in his gross estate to the extent it would be includible under section 2033 or some other provision of part III of subchapter A of chapter 11.

The decedent, Charles Brown, was certainly the owner of the property and he could unquestionably dispose of it. He may not have disposed of his property by bequest, but he chose to do so by an act of omission. The VA hospital application on a prior hospital admission, gave him notice of what would result if the property were not disposed of will. And so, the property is part of the gross estate.

Appellee at pp. 22-24 asserts that the legislative history of 38 U.S.C. 5220 is "irrelevant and inconclusive." New York State disagrees, legislative history is always relevant and in the case at bar is clear. The proposed bill (HR 5692) which included 5220 and other related provisions was submitted to the Committee on War Veteran's Legislation and their analysis and suggestions* were codified as 38 U.S.C. 5224:

§ 5224 *Disposal of Remaining Assets*

The remainder of such assets . . . shall become assets of the United States as trustee for the fund . . . *If there is administration upon the estate* such assets, other than money shall be delivered by the administrator of the estate to the estate to the Administrator [of

* See H.R. Report No. 609, p. 2, 77th Cong.

Veteran's Affairs] . . . as upon final distribution; and upon the same claim there shall be paid the treasurer of the United States for credit to the fund *any such money* available for final distribution. *In the absence of administration*, any money, chose in action, or other property of the deceased veteran . . . shall be paid or transferred to the administrator upon demand by him . . . (Emphasis added).

This bill contemplates the possibility of administration of the assets in the decedent's estate, depending on whether or not the laws of the State provide for administration.**

The New York State Court of Appeals has ruled that an estate tax administration was required where a deceased veteran died intestate leaving property escheating to the United States as trustee. (*Matter of O'Brine, supra*). It is submitted that this Court should apply the ruling in *Commissioner v. Bosch*, 387 U.S. 456 (1967), and apply the law of the State's highest court on its own law even when the application of a federal statute is involved (387 U.S. at 465). Therefore, the property passing to the United States from the decedent's estate is subject to an estate tax proceeding required by New York.

POINT III

Non VA derived assets passing to the United States Government pursuant to 38 U.S.C. 5220 are not deductible from the decedent's gross estate.

Appellee maintains that New York must adopt Federal estate tax deductions. This is not correct. There are certain situations where a federal tax law may be adopted by a state, but this is not one. The so-called "piggyback"

** See *Hamilton v. Brown*, 161 U.S. 256 at 275 (1896) to the same effect.

law* provides that federal income tax returns may be used to allow a state to derive its tax through a formula based on the federal income tax return data, and a state tax return is not filed. The United States and the state must reach a formal agreement on the "piggyback" provision. New York State has never elected to adopt the federal income tax and no such arrangement exists with respect to estate tax either. When a federal determination is erroneous, the State makes its own independent audit and findings. Such audits by the State are commonplace, especially in smaller estates where no federal tax is due and hence the I.R.S. has little incentive to audit. Section 955a of the New York tax law which utilizes federal deductions is far from being a "sacred cow" to the State. New York obviously feels that the deduction of the decedent's non-Va derived assets is erroneous or else it would not have participated in this litigation.

The United States asserts that the personal property of the decedent herein is "exempt on two grounds"

- 1) As a charitable pledge under Treas. Reg. 20.2053-5.
- 2) As a claim against the estate (for a liability imposed by law) under Treas. Reg. § 20.2053-4.

The appellee uses the term exempt at p. 27 of its brief, but we presume it is actually referring to deductions. Even the then I.R.S. Commissioner Alexander did not believe the United States' assertion that § 5220 assets were deductible as a claim against the estate pursuant to Treas. Reg. 20.2053-5. In his letter to then administrator of Veteran's Affairs (Richard L. Roudebush)** it was asserted:

We believe that Code Section 2053, which allows deductions for claims against the estate, inapplicable . . .

* * * *

* Public Law 92-512, Oct. 20, 1972, 86 Stat. 936.

** Record on Appeal, Document 2, Exhibit 4, pp. 5, 6.

Mr. Alexander, however, does believe that these assets are deductible as a charitable pledge:

Thus, an agreement, in which, in return for care or treatment, the veteran promises to assign his personal property to the United States if he should die intestate and without legal heirs while in a Veteran's Administration facility is presumed.

Treas. Reg. section 20.2053-5 allows a deduction for a charitable pledge or subscription under subpart (a) to the extent that there is adequate and full, consideration in cash or its equivalent.

We disagree with Mr. Alexander's latter interpretation as applied in the instant case. Section 20.2053-5 is also inapplicable. Since the decedent was a veteran over the age of 65 when he applied for and received, medical assistance at the VA facility in the Bronx, he was entitled to such assistance without charge under 38 U.S.C. § 610(a)(4). This conclusion had been confirmed directly by the General Counsel of the Veteran's Administration. (Letter to Allan E. Kirstein, Assistant Attorney General dated 10/25/77, Addendum, 1a).

Thus, no deduction may be claimed under § 20.2053-5 since the requirement of "adequate and full consideration" was not satisfied. And the applicable Revenue Ruling 75-533, which adopts Commissioner Alexander's reasoning with respect to applying 20.2053-5 to 5220 assets as a charitable pledge is erroneous since Mr. Brown was average 65 when he received VA medical care and this was not contemplated in Rev. Rul. 75-533.

Furthermore, we believe the I.R.S. Revenue Ruling to be completely erroneous because there is not a scintilla of evidence that the decedent intended to make a charitable pledge to the United States. Absent any donative intent, any deduction as a charitable pledge or gift is clearly incorrect.

The second point raised by appellee is that an exemption may be claimed against the estate for a liability imposed by law under Treas. Reg. 20.2053-4. Since the property passes to the United States as trustee in its custodial capacity, no liability is imposed.*

Appellee points out that New York is in error in asserting that the property is held forever available to heirs who come forward to claim it at any time because section 5226 limits the period of claim to five years after the veteran's death (appellee's brief, p. 31). In *Matter of Hammond*, 3 N Y 2d 567 (1958), on the basis of an official opinion by the Solicitor of the V.A. (appellant's appendix p. 10a) that the five year provision of 5226 is not applicable when based on payment to the V.A. due to a "mistake of fact" and there is no time limit in such an instance.

Even assuming *arguendo* that the five year limitation applied, the United States would still be a trustee since the estate tax is determined by the date of death status of the claim. An estate tax is a lien as of the date of death and at that point the United States is entitled to receive the funds solely as a trustee.

The appellee further maintains that the United States is a trustee for the General Post Fund and that the rightful heirs are paid from a separate fund. This is not a very meaningful argument because it merely constitutes a bookkeeping measure and the United States is just receiving the money in one pocket and paying it back out of the other pocket. Thus, non-VA derived assets passing to the United States under 38 U.S.C. 5220 are not deductible from the decedent's gross estate.

* See Appellant's Brief, p. 15.

POINT IV

The United States District Court should not have entertained jurisdiction.

The appellee contends that the mere involvement of a federal statute justifies the removal of a segment of the administration proceeding to the Federal District Court for determination since the United States is a party. The Supreme Court of the United States has held:

The fact that plaintiff is the United States does not justify [seeking relief in federal courts.] The government insists that it is entitled to have its claim determined in its own courts. But the grant of jurisdiction to the District Court in suits brought by the United States does not confer exclusive jurisdiction . . . Upon the state courts equally with the courts of the Union rests the obligation to guard and enforce every right secured by the court and laws of the United States whenever those rights are involved in suits before them. In this instance . . . The United States is free to invoke the jurisdiction of the state court for the determination of its claim and the decision of any state court may be reviewed by this Court.

We cannot see that this would be impairment of any rights the United States may possess or any sacrifice of its proper dignity as a sovereign, if it prosecuted its claim in the appropriate forum where the funds are held. *United States v. Bank of New York Company*, 296 U.S. 463 at 479, 480 (1936).

Here the funds were administered through the Surrogate's Court of Bronx County, and the United States, like any other claimant, should be required to submit to that forum.

Appellee's brief (p. 32) cited *Nico v. Commissioner*, Dkt. No. 77-4090 Slip op. 365, 369 for the proposition that an

IRS ruling "should be sustained" even though there may be another reading which the court might think preferable. The United States has misread the opinion of this Court in *Nico* which merely sustained a prior ruling because a subsequent ruling was cryptic and internally inconsistent.

We submit that Mr. Justice White's comments in *United States v. Cartwright*, 411 U.S. 546 (1973) are far more appropriate.

"We recognize that this Court is not in the business of administering the tax laws of the nation. Congress has delegated that task to the Sec'y of the Treasury, 26 USC § 7805(a) and regulations promulgated under his authority, if found to implement the congressional mandate in some responsible manner, must be upheld. (citations). *But that principle is to set the framework for judicial analysis; it does not displace it.* We find the contested regulation is unrealistic and therefore affirm the judgment of the Court of Appeals [which affirmed the District Court which had held the regulation invalid]". (Emphasis supplied) (411 U.S. at 550)

CONCLUSION

1. Congress was without power to declare an escheat under 38 U.S. 5220 as to property which was not derived from VA benefits.
2. Property passing to the United States under 38 U.S.C. 5220 is subject to estate tax under Article 26 of the New York Tax Law.
3. Non-VA derived assets passing to the United States Government pursuant to 38 U.S.C. 5220 are not deductible from the decedent's gross estate.
4. The United States District Court, Southern District of New York, should not have entertained jurisdiction.

Dated: New York, New York
December 8, 1977

Respectfully submitted,

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Attorney General of the
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Addendum 1a.

VETERANS ADMINISTRATION
Office of General Counsel
Washington, D.C. 20420

OCT 25 1977

IN REPLY
REFER TO: 023

Received
by mail

OCT 27 1977

Department of Law
New York City Office

Mr. Louis J. Lefkowitz
Attorney General of the
State of New York
Two World Trade Center
New York, New York 10047

Attention: Mr. Allan Kirstein
Assistant Attorney General

Dear Mr. Attorney General:

This will respond to your letter to our General Counsel regarding veteran Charles W. Brown, deceased, who died in the Bronx Veterans' Administration Hospital on March 5, 1973, at the age of seventy-five. You state that he had been previously hospitalized at the same facility in October 1972.

The medical and administrative records of the veteran's hospitalization are with the Assistant U.S. Attorney (New York), Mr. William J. Hipsher. We understand that he has contacted, or will contact, you concerning this matter.

A copy of your correspondence and our reply is being forwarded to Mr. Hipsher for his information.

In answer to your inquiry, Public Law 91-500 enacted a new subsection (a)(4) to section 610 of title 38, United States Code. This subsection provides that the Administrator, within the limits of Veterans' Administration facilities, may furnish hospital care or nursing home care which the Administrator determines is needed to any veteran for a nonservice-connected disability if such veteran is sixty-five years of age or older. Such veteran is entitled to treatment without swearing or affirming that the veteran is unable to defray the necessary expenses of treatment.

Public Law 91-500 was enacted on October 22, 1970. Since the veteran, according to your letter, was hospitalized at the VA Hospital, Bronx, New York in October 1972, he was entitled to treatment without charge.

We trust the above is responsive to your inquiry.

Sincerely yours,

CHARLES M. JOHNSTON
Assistant General Counsel

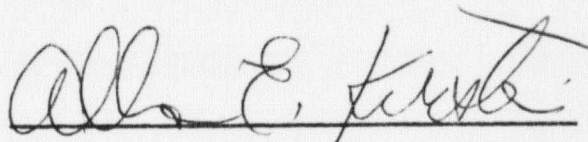


STATE OF NEW YORK)
 : SS.:
COUNTY OF NEW YORK)

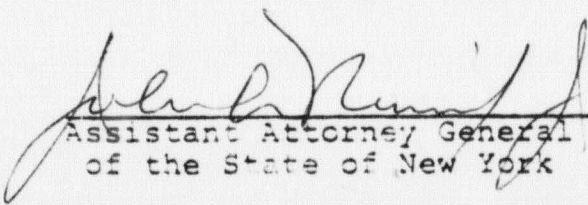
ALLAN E. KIRSTEIN , being duly sworn, deposes and
says that he is employed in the office of the Attorney
General of the State of New York, attorney for State of New York
herein. On the 12th day of December , 1977 , he
served the annexed upon the following named person :

WILLIAM HIBSHER, ESQ.
Assistant United States Attorney
5th Floor
One St. Andrew's Plaza
New York, N.Y.

Attorney in the within entitled proceeding by depositing
three
A true and correct copy^{ies} thereof, properly enclosed in a post-
paid wrapper, in a post-office box regularly maintained by
the Government of the United States at Two World Trade Center,
New York, New York 10047, directed to said Attorney at the
address within the State designated by him for that purpose.



Sworn to before me this
12th day of December , 1977



Assistant Attorney General
of the State of New York